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SUBJECT: STRENGTH OF THE COLOMBIAN PESO: HOW HEAVY IS THE  
EXPORTERS' ALBATROSS?

REF: A. BOGOTA 2918  
[1](#)B. BOGOTA 2053

[1](#)1. (SBU) SUMMARY. Since 2003, the Colombian peso has averaged about nine percent annual nominal appreciation against the dollar. The revaluation, a product of global economic pressures and Colombia's improved economic and security situation, has been more pronounced in the last two years and is taking a toll on exporters, who see their products becoming less competitive. The short-term policy tools available to the GOC in the current inflationary environment are limited and only marginally effective. Nonetheless, exports continue to grow, as sectors consolidate and re-orient toward higher value-added activities. In the future, the export sector's ability to increase productivity, not the benefits of a cheap peso, will determine its competitiveness. END SUMMARY.

AN APPRECIATION EXPORTERS DO NOT APPRECIATE  
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[1](#)2. (SBU) The peso has appreciated steadily in nominal terms since early 2003, when a dollar bought almost 3000 pesos. From its weakest point in 2006 of 2634 pesos/dollar (June 29), to its strongest point so far in 2008 of 1652 pesos/dollar (June 19), the peso appreciated by 59.4 percent (in nominal dollars-per-peso terms). Add to that the fact that Colombia's annual inflation rates over the last several years have totaled around 4-6 percent, while U.S. figures for the same period reached only 2-3 percent, and the real appreciation of the peso is even more pronounced. Export sectors, including coffee, cut flowers, and textiles, are complaining that the strong peso threatens to put their companies out of business and could drag down the overall economy (Ref A).

A PRODUCT OF GLOBAL PRESSURES AND COLOMBIA'S OWN SUCCESS  
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[1](#)3. (SBU) Deputy Minister of Commerce Eduardo Munoz offered four principal causes of the peso's appreciation. First, and most important, are global pressures toward a weak dollar, over which Colombia has no control. Second, Colombia's success in its economic goals of increasing exports, attracting more greenfield investment, and increasing tourism. Third, the relatively large interest rate differentials between the U.S. and Colombia as a result of the Colombian Central Bank trying to fight inflation put further pressure on the peso to appreciate. Finally, expectations of the peso's further appreciation in foreign exchange markets creates speculative pressure toward

appreciation.

#### THE PSYCHOLOGY OF 2000 PESOS

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¶4. (SBU) When asked what they would consider an appropriate exchange rate, most exporters offer figures ranging from 2000 to 2200 pesos/dollar. Juan Lucas Restrepo, Commercial Manager of the National Federation of Coffee Growers, said that any rate greater than 2000 pesos was manageable, but that spot rates of less than 1700 (as was the case for several days in June) are not sustainable for many growers. Roy Azout, Managing partner of Lafayette textile factory picked 2100-2200 pesos as an appropriate level, but admitted that what passed for a "comfortable" exchange rate today would have seemed dangerously strong just two years ago. Munoz said he sensed relief from exporters on news that the peso had sustained an exchange rate of more than 1800 pesos for the entire second week of August.

#### POLICY TOOLBOX IS LIMITED

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¶5. (SBU) Colombia has maintained a floating exchange rate regime since 1999. While the Central Bank has the authority to intervene in the exchange market, and has done so in the past, its primary focus on inflation limits its ability to bring down the peso's value through open market operations. The GOC has had capital controls in place since May 2007 (ref B), but most experts agree they have done little to stem the peso's appreciation. President Uribe stated recently that

his administration continues to study options to ease or eliminate the controls. Javier Diaz Molina, President of the National Association of Foreign Trade (Analdex), noted the importance of GOC action on the macro and micro level to help exporters weather a period of revaluation. On the macro side, he recommended reducing public spending so as to ease inflationary pressures, which would allow interest rates to come down. On the micro side, he endorsed GOC tax benefits to exporters when the exchange rate was fewer than 2,000 pesos per dollars and targeted subsidized lines of credit.

¶6. (SBU) In addition to the peso's overall appreciation, AmCham Executive Director Miguel Gomez noted the recent volatility that had characterized the peso-dollar exchange rate and frustrated exporters. In the ten-day period from June 24 to July 4, the peso moved from 1714 pesos/dollar to 1923 and then back down to 1748. While Gomez acknowledged that many exporters use futures contracts and other derivatives to hedge against volatility, he said that Colombia's shallow peso-dollar market left it vulnerable to extreme fluctuations when multinational corporations made large transactions.

#### GROWING EXPORTS BELIEVE CHORUS OF WOE

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¶7. (U) Colombia's total exports are on pace to increase by 27 percent in 2008, after increases of 23 percent in 2007, and 15 percent in 2006. Exports increased by 128 percent between 2003 (when the sustained peso appreciation started) and 2007.

Even sectors mentioned as being hit hardest by the peso appreciation -- cut flowers and textiles -- have posted positive export growth (in both peso and dollar terms).

¶8. (SBU) The U.S. and Venezuela (whose official exchange rate is pegged to the dollar) are Colombia's two principal export markets and account for over half of Colombia's total exports. Exports to each of these countries grew in the face of the peso's appreciation in 2007 -- by 6 percent to the U.S. and by 96 percent to Venezuela. While many attribute part of the large increase in exports to Venezuela to overinvoicing, Munoz noted that Venezuelan demand for imports has grown tremendously due to the inability of domestic producers to satisfy consumer desires, coupled with huge inflows of petro-dollars. With the euro-peso nominal exchange rate largely stable, Colombian exports to Euro-zone

countries increased in 2007, but still accounted for only about 13 percent of the total.

#### RENEWED FOCUS ON PRODUCTIVITY: REVALUATION'S SILVER LINING?

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¶9. (SBU) According to Munoz, many companies entered certain export sectors due to an undervalued exchange rate, but had made no efforts to increase productivity, and therefore would go out of business with the appreciation of the peso. On the other hand, the revaluation had prompted many export-oriented companies to re-orient their production toward activities and product-lines with the highest value-added. According to Munoz, the GOC focuses on creating jobs by promoting increased productivity and developing a handful of world-class sectors, in areas such as business process outsourcing, cosmetics, pharmaceuticals, and biotechnology.

#### COMMENT: LEARNING TO LIVE WITH A STRONG PESO

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¶10. (SBU) Undoubtedly, the revaluation over the last several years has spurred consolidation in export sectors and taken the less competitive actors out of the market. Nonetheless, savvy policy-makers realize, first, that there is little they can do about the revaluation of the peso, and second, that there can be benefits to a stronger peso, such as cheaper capital imports and a renewed focus on efficiency. Gone are the days when exporters could lean on an exchange rate crutch to be competitive. Colombia's export sector's success in the medium and long term will depend on its ability to adapt to, and take advantage of a stronger peso.

BROWNFIELD